

**Minutes of the Meeting of the  
Treasury Borrowing Advisory Committee  
of the Securities Industry and Financial Markets Association  
April 29, 2008**

The Committee convened in closed session at the Hay-Adams Hotel at 10:35 a.m. All Committee members were present. Undersecretary for Domestic Finance Robert Steel, Assistant Secretary for Financial Markets Anthony Ryan, Deputy Assistant Secretary for Federal Finance Matthew Abbott, and Office of Debt Management Director Karthik Ramanathan welcomed the Committee and gave them the charge.

Director Ramanathan initiated the discussion by addressing the first item on the charge related to the fiscal outlook and the Committee's thoughts on debt issuance given current and medium-term trends in the economic outlook. In particular, Treasury sought the Committee's views on the potential introduction of new securities, including the 52-week bill.

Director Ramanathan delivered a presentation to the Committee which highlighted various factors to consider including the flat growth of individual and corporate income taxes year-over-year, the increase in outlays by nearly 6% year-over-year, and the impact of the stimulus program enacted in February 2008. These factors have led to a substantial increase in deficit estimates by market participants, with the average deficit estimate rising nearly \$156 billion to \$414 billion.

Moreover, according to Director Ramanathan, marketable borrowing – i.e. borrowing from the public - has increased from \$134 billion in fiscal year 2007 to nearly \$300 billion fiscal year to date in 2008, and this large increase warranted the Committee's focus.

Director Ramanathan noted that the redemptions and outright sales by the Federal Reserve since August for liquidity purposes have resulted in the Treasury's need to issue an additional \$200 billion in bills and coupons this fiscal year. Moreover, state and local government issuance, which totaled \$58 billion in fiscal year 2007, is -\$10 billion (i.e. a net redemption) fiscal year to date. This issuance is not expected to reverse in the near term. These factors, as well as volatility in receipts and outlays, have resulted in less predictable cash balances making cash management an ongoing challenge. In addition, Director Ramanathan stated that the rapid processing of tax refunds from February to April combined with the tax rebates to be transmitted this week have resulted in the increased use of cash management bills.

Treasury has increased bills and nominal coupons in accordance with previous periods of increasing deficits, according to Director Ramanathan, who then displayed a comparison of the 2001-2002 issuance period versus the 2007-2008 period. At the same time, Treasury has moderated the growth of Treasury Inflation Protected Securities (TIPS) in order to further balance the overall portfolio. Director Ramanathan noted that while the par growth of TIPS has exceeded 20% over the past seven years on a compounded annual growth rate, the inflation accrual portion – which is much less predictable from Treasury's perspective – has grown at nearly 27% over the same period. This moderation in the growth of the program, along with the

near term challenges associated with maturing coupons, leads to additional financing needs in the near to medium term. Moreover, enhancing tools for cash and debt management purposes, such as increased repo authority and using excess cash balances in a highly transparent manner to repurchase debt, should be considered and potentially implemented.

With this background, and given current trends, Director Ramanathan asked the Committee its views on debt issuance, and in particular, the introduction of the 52-week bill.

One Committee member framed the discussion by stating that there are two perspectives that need to be considered: a shorter-term perspective and a longer-term perspective. The member discussed the current issue sizes for all current offerings and enumerated the responses that Treasury could undertake to meet the gap in the funding needs, including increasing issuance sizes, increasing the frequency of offerings, and adding new instruments.

Another member stated that a proper response to the question involved how Treasury viewed the balance of risk going forward. In response, Director Ramanathan stated that maintaining the status quo at current issuance levels with the current offering menu would leave Treasury with a financing gap approaching \$150 billion for the remainder of FY08. In addition, the risks to the deficit were potentially to the upside based on the assessment on the economic outlook by market participants.

Director Ramanathan also affirmed that Treasury had issued over \$200 billion in cash management bills fiscal year to date in 2008 versus \$267 billion in all of fiscal year 2007 and \$247 billion for all of fiscal year 2006. While the dramatic shift in the deficit necessitated such short term issuance, Director Ramanathan stated that alternative funding sources should be considered to lessen or moderate this reliance on short dated financing.

One member noted that the yield curve was steep, and that demand for Treasury bills was very high, particularly from non-traditional sources. As a result, bills were the optimal instrument for financing the current fiscal outlook. Several members countered by stating that such demand could reverse if economic or financial market conditions revert.

A few members also noted that 13-week and 26-week bill auctions could be increased from current offering amounts without market dislocations. Members generally agreed that short-dated debt, including 52-week bills to address current funding needs, would be potentially be less costly than adding more frequent longer issues and/or adding new maturity points.

A discussion then ensued regarding the risks of increased borrowing in the short end of the curve, particularly regarding rollover risk and exogenous events that may raise debt service costs in the future. Members noted that more than forty percent of Treasury's debt rolls over in two years or less, and that Treasury already has a bias toward the short-end of the curve. Another member stated that Treasury may want to consider an average maturity target to better hone its decision-making process on how to adjust the maturity structure. This member noted that focusing on the short-end of the curve for financing because it was currently cheap was short-sighted and may not minimize costs over the longer-term.

Some members pointed out that the recent demand for short-dated Treasury paper reflected a re-pricing of risk that could unwind at some point, raising borrowing costs. Another member noted that the swap markets were already pricing in higher future rates for Treasury as measured by spreads to LIBOR. A member suggested that shifts in foreign demand could create pressure in the short end of the curve, while another member suggested that pressures on fund managers to outperform the Treasury market were already causing some accounts to start considering riskier assets.

Several members agreed that Treasury debt managers should remain extremely flexible given the uncertainty in the economic outlook and given the significant increase in marketable borrowing needs. A Committee member stated that debt managers generally had an extremely complex mission in the current environment given the uncertainty present in the economy and the fiscal outlook. According to this member, Treasury should be forward looking despite the large volatility of deficit estimates, and keep in sight structural changes which may emerge related to entitlement programs and tax policy. Such a forward looking posture could result in a longer dated portfolio with issuance focused in the note and bond sector. Several members concurred, and noted that Treasury should ensure it had sufficient tools to address medium term challenges, including enhanced repo authority and a debt repurchase program.

Members generally agreed that Treasury should reintroduce the 52-week bill in June and auction the security as it was previously issued - on a 4-week rolling basis. Auctioning the 52-week in conjunction with the 4-week bill on Tuesdays with settlement on Thursdays would be better received by the markets, and also leave room in the auction calendar if other changes were necessary, such as additional re-openings or issuances of an existing security such as the 10-year, or the introduction of a new security.

While members agreed that the 52-week bill was necessary to address short term financing needs, there was more debate about how to address intermediate term funding needs. Some members felt that the 3-year note could be reintroduced without much difficulty. Several other members suggested that introducing a longer-dated instrument such as the 7-year note or moving to monthly 10-year note issuance were better alternatives. These members noted that there was significant demand for 7- to 10 year paper, in part, because of shifts in the mortgage market and the need to hedge fixed rate loans and demand for deliverable paper into the 5- and 10-year futures contracts. Several members also felt that issue sizes in longer-dated securities could be increased further.

The Committee agreed that Treasury needed to be very transparent about what steps might be needed to address intermediate-term funding needs, and prepare the market for financing changes that are needed, including adjusting issue sizes of longer-maturity instruments, increasing the frequency of issuance of securities, and/or adding new offerings. The Committee felt that as early as the August 2008 refunding, Treasury may consider making statements about their intentions if the economic or fiscal outlook deteriorate and/or become clearer.

The Committee then focused its attention on second item on the charge related to recent actions by market participants to address fails to deliver in the Treasury repurchase market. At

the February Refunding, Treasury had discussed the potential for an environment in which lower interest rates raised the potential risk of systemic fails, a risk that potentially impairs liquidity and raises the cost of borrowing. Treasury at that time asked market participants to pursue the identification and implementation of market oriented solutions to help mitigate such a development.

Treasury specifically asked for the Committee's view on actions taken by market participants, what other steps should be undertaken and what type of timeline and benchmarks would be most effective.

A series of charts related to this matter were presented by a Committee member including a chart of the relation of low rates to Treasury fails to deliver, as well as recent actions in the market which have improved overall liquidity. The presenting member, along with DAS Abbott, outlined efforts initiated by groups such as the Securities Industry and Financial Markets Association (SIFMA) and the Treasury Markets Practice Group (TMPG).

In the series of charts, a list of action items to be taken by SIFMA was listed. These steps, such as negative rate trading, a mini-repo closeout clause, a strengthening of the buy-in rule, closer fails monitoring, compliance officer training, and best practices, would incrementally assist in the reduction of fails in a low rate environment. SIFMA and the TMPG noted that these actions, to be taken by private market participants, could mitigate the next serious emergence of fails.

According the presenting member, SIFMA and the TMPG supported the enactment of these initiatives to prevent another set of systemic fails. The member made a distinction between systemic fails that were difficult to control – such as those related to investors not lending securities at the end of their fiscal years for financial reporting reasons - and fails which may result from deliberate positioning actions by market participants in low-rate environment. The presenting member also outlined the initiatives and role of the TMPG in greater detail.

A discussion followed the presentation.

Committee members were encouraged by the collaborative efforts undertaken by the industry groups to formulate viable solutions to address chronic fails. Members discussed other private and public sector measures that could more effectively address chronic fails including negative rate trading, broader netting mechanisms for buy-side and sell-side participants, and targeted increases to supply through scheduled and unscheduled re-openings. The Committee agreed that the TMPG, in conjunction with SIFMA and other private sector entities, should give further consideration to these and other initiatives.

One member asked why Treasury does not tap issues to deal with fails. DAS Abbott explained that tapping an issue for such a purpose would reduce the certainty of supply at initial auction, and introduce a concession into prices received at auctions.

One member cautioned that “boundary” rules, such as the buy-in rule, could be gamed and warned that such constraints could create unintended problems. Members thought that moral

suasion and ambiguity were better tools for addressing problems than rigid regulatory structures. Members felt that fails largely were a problem at low interest rate levels because the cost of fails declines dramatically. Many members felt that if the cost of failing could be decoupled from the interest rate levels, the economic incentives would be sufficient to prevent most systemic fails episodes.

One member noted that the model for many of the proposals for dealing with fails came from equity markets, and equity market rules may not be appropriate for the Treasury market. The member noted that unlike the equity markets where participants generally hold long positions, the Treasury market is characterized by much more short selling. In markets where there are more short positions than long positions, flexibility is needed.

Another member noted that systemic fails tend to occur in low-interest rate environments when financial markets are being stressed, and that rigid rules will exacerbate market dislocations. Furthermore, every event that created systemic fails is different and the flexibility associated with moral suasion is most efficient and will not burden market participants with additional regulatory requirements. This member stated that self-policing was necessary, and that compliance and supervisory authorities needed to be reminded of the importance of monitoring fails.

The Committee agreed, however, that that private sector *inaction* would potentially lead to less preferable outcomes including potential increased regulation, capital charges, or other responses. Implementation of the steps outlined and recommended by the TMPG and SIFMA in an incremental manner, and in a short time frame, would negate such potential responses if another large fails episode occurred.

Finally, the Committee briefly addressed the final item on the charge concerning recent and potential measures to address issues in the housing market. Treasury sought the Committee's views on recent initiatives taken by the private sector, Treasury, and other sectors of the federal government to address challenges in the housing sector, and asked what other potential fiscal policy measures should be considered and evaluated in light of the projected borrowing needs of the Treasury.

Members discussed several pending legislative efforts in Congress. A few members noted that providing economic incentives to both home owners and lenders to renegotiate the terms of the defaulted mortgages may be a worthy effort. These members suggested that the lack of a "floor" on housing prices is adversely affecting the price and liquidity of mortgage debt, and until a floor is established on the underlying collateral, mortgage paper associated with the collateral will continue to be illiquid and impair credit markets.

Other members suggested that a lot of details still needed to be addressed regarding the various proposals. Litigation risks associated with the renegotiation of defaulted loans would be a potential major hurdle according to some members. Another member asked how second liens would be dealt with, and how any proposal could be structured to prevent currently compliant mortgagees from forcing renegotiation of their loans.

Some members then questioned of the wisdom of such proposals to the degree that it created a moral hazard for borrowers to default. Some members suggested that the risk associated with the moral hazard may be less than the systemic risk of doing nothing. Moreover, these members stated that a temporary floor on prices was not a good option, and that the market should work its way out of this mess without government intervention. Other members questioned the longer-term wisdom of using taxpayer money to rescue risk-takers that speculated in an asset bubble.

The Committee agreed that most of the proposals under consideration were fraught with issues, and that seeking a “best fit” would be difficult.

The meeting adjourned at 11:58 a.m.

The Committee reconvened at the Hay-Adams Hotel at 6:00 p.m. All the Committee members except Gary Cohn and Mohammed El-Erian were present. The Chairman presented the Committee report to Under Secretary Steel.

The Committee then reviewed the financing for the remainder of the April through June quarter and the July through September quarter (see attached).

A brief discussion followed the Chairman's presentation but did not raise significant questions regarding the report's content.

The meeting adjourned at 6:15 p.m.

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Karthik Ramanathan, Director  
Office of Debt Management, United States Department of the Treasury  
April 29, 2008

Certified by:

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Keith T. Anderson, Chairman  
Treasury Borrowing Advisory Committee  
of The Securities Industry and Financial Markets Association  
April 29, 2008

**Treasury Borrowing Advisory Committee Quarterly Meeting  
Committee Charge – April 29, 2008**

Fiscal Outlook

Given current and medium-term trends in the economic outlook, what are the TBAC's thoughts on Treasury's debt issuance? In particular, Treasury would like the Committee's views on the potential introduction of new securities, including the 52-week bill.

Recent Actions by Market Participants to Address Fails to Deliver in the Treasury Repurchase Market

At the February Refunding, we discussed the potential for an environment in which lower interest rates raised the potential risk of systemic fails, a risk that we believe impairs liquidity and raises our cost of borrowing. In addition, we asked market participants to pursue the identification and implementation of market oriented solutions to help mitigate such a development.

What is the Committee's view on actions taken by market participants? What other steps would you suggest be undertaken? What type of timeline and benchmarks would be most effective?

Recent and Potential Measures to Address Issues in the Housing Market

Treasury would like the Committee's views on recent initiatives taken by the private sector, Treasury, and other sectors of the federal government to address challenges in the housing sector.

What other potential fiscal policy measures should be considered, and how should they be evaluated in light of the projected borrowing needs of the Treasury?

Financing this Quarter

We would like the Committee's advice on the following:

- The composition of Treasury notes and bonds to refund approximately \$74.0 billion of privately held notes maturing on May 15, 2008.
- The composition of Treasury marketable financing for the remainder of the April-June quarter, including cash management bills.
- The composition of Treasury marketable financing for the July-September quarter.